

**Business Law:
Contracts**
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While at the University of Texas, Professor Cross has taught undergraduate classes, MBA classes, and executive education courses in aspects of the legal environment in business. He has received numerous awards, including departmental awards, MBA teaching awards, College of Business Administration awards, and one university-wide teaching award. Professor Cross also was honored as the nation's outstanding professor by the Academy of Legal Studies in Business. He was recognized as a top teacher by the *Business Week* guide to MBA programs.

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Business Law: Contracts

Scope:

Contractual agreements are one of the principal mechanisms for ordering life in society. Whether a contract is written or oral, or even implicit, it carries with it all of the duties and obligations that society has endowed with the force of law. Contracts are of paramount importance in regulating transactions of goods and services, and so the laws surrounding contracts are a key field of business law. This series of eight lectures lays a comprehensive foundation in the practical and intricate body of law that governs contracts. “Reasonable” expectations surrounding contracts have acquired specific legal ramifications that this series endeavors to explain.

Lecture One explores the boundaries of contracts in law. It discusses the four main requirements that any contract must satisfy, and it discusses the Uniform Commercial Code of the United States, which incorporated common law about commercial contracts into state statutes. Lectures Two and Three give greater detail about the main components of a contract. Lecture Two examines the preliminary issues of offer and acceptance, including the ability of parties to negotiate, the definiteness of a contract’s terms, and terms of acceptance. Consideration (the items or services being exchanged) is made up of several components which are discussed in Lecture Three, along with the legal capacity of minors to contract, and the issue of fraud.

Lectures Four through Six consider the possible reasons for declaring contracts void or breached, as well as remedies available under law. In Lecture Four, the problem of assent is discussed; whether there has been a mistake or misrepresentation about key facts will affect the legality of a contract, as well as issues such as duress or unconscionable requirements. Lecture Five reviews problems with the performance of a contract, including how much of a performance is required to consider a contract discharged, and other legal reasons for discharge. Remedies for breaches of contract, and different methods for assessing the fair compensation in such cases, are considered in Lecture Six.

The series concludes with discussions of two unique issues in contract law: third-party rights in contracts, and international contracts. Lecture Seven explains the categories of persons who are legally permitted to enforce agreements to which they are not original contracting parties. These might include beneficiaries of the contract, or an assignee of a certain part of a contract. Finally, Lecture Eight broaches the subject of international contracts, and the practical and legal complications arising therefrom. A discussion of the United Nations Convention on the International Sale of Goods in contrast with U.S. law is included.

Lecture One

Foundations of Contract

Scope: Contractual agreements, one of the most fundamental elements of business life, have been scrupulously defined under law. Under the common law of contracts, which stretches back centuries, a contract can be in many forms and still be legal. Even unspoken contracts can be legally binding if all the other conditions, as put forth in this lecture, are met.

Outline

I. Defining a Contract. The requirements of a contract are legally defined, and contracts need not always appear formal or be in writing or even spoken. Every contract, though, involves an agreement to exchange promises or acts. There are four basic requirements for a contract.

- A. Agreement:** a voluntary offer and acceptance regarding certain terms.
- B. Consideration:** the exchange of something of legal value. This is often goods or money but it may simply be a promise not to take certain action.
- C. Capacity:** the ability to make a binding contract. Minors, for example are limited in this capacity.
- D. Legality:** the lawfulness of the contract's subject matter.

For some limited types of contracts, there is also a **form** requirement, such that the contract must be in writing to be effective.

II. Types of Contracts

- A. Unilateral or Bilateral.** Most contracts involve a promise in exchange for a promise. These are bilateral contracts and both sides are bound to carry through on their promise. Some contracts are unilateral, which involve a promise for an act. Here, the promisor is not bound until the act is performed.
- B. Written or Oral.** Although most contracts need not be in writing, putting the deal in writing is generally advisable. When there is a writing, it overrides any oral side deals. The law has some presumption that large deals will be put into writing.
- C. Express or Implied.** Most contracts are expressed in words, written or oral. A contract may be implied, though, without any words whatsoever, if the circumstances and parties' actions indicate that they contemplated a bargain.
- D. Void, Voidable or Unenforceable.** A void contract is one without any legal effect, such as an illegal contract. A voidable contract is temporarily effective but can be voided by one side to the contract, such as a minor. An unenforceable contract is one that cannot be enforced in court for a reason such as the statute of limitations.

III. Uniform Commercial Code

Contract law was built up over centuries of common law. In the United States, the Uniform Commercial Code takes these common law doctrines and incorporates them into state statutes. All states except Louisiana have passed the bulk of the U.C.C. The Uniform Commercial Code is limited to transactions in goods and does not extend to service contracts.

IV. Contractual Variants

- A. Quasi-Contracts.** This is a contract imposed by law, in the absence of voluntary agreement. They are disfavored but may be imposed when fairness requires and particularly when the parties presumably would have made a contract but were prevented by circumstances (e.g., an emergency rescue).
- B. Promissory Estoppel.** Ordinarily the law does not enforce gifts or promises without consideration. An exception is made in promissory estoppel when a party's unilateral promise induces justifiable reliance by the other party.

Review Questions

1. Susan and Jack had given each other birthday presents for many years. When Jack forgets her birthday, she sues for breach of an implied contract. Should she win?

No, the court would presume that birthday presents are not contractual but are gifts without consideration.

2. To have a binding quasi-contract, must a party show some evidence of an intention to agree to terms?

No, a quasi-contract is imposed by courts out of considerations of fairness and requires no evidence of agreement.

3. Under what doctrine will the courts sometimes enforce a simple promise or gift?

Courts may enforce promises of gifts under the doctrine of promissory estoppel.

4. What are the basic legal requirements of a contract?

Agreement, Consideration, Capacity, Legality, and sometimes Form

5. Jamal offers Howie a thousand dollars if Howie swims the English Channel. What type of contract is formed, and how would Howie accept?

This would be a unilateral contract, and Howie could accept only by actually swimming the Channel.

6. After you enter a contract with your lawyer, you feel that it has been breached. Is this contract governed by the terms of the Uniform Commercial Code?

No, the U.C.C. does not apply to contracts for services.

7. What is the practical difference between a void contract and a voidable contract?

A void contract has no legal effect, but a voidable contract is binding until the party chooses to exercise the option to void its terms.

8. Margaret contractually agreed to serve as a surrogate mother for an infertile couple. After giving birth she sought to keep the baby. What argument should she make to try to escape the contract?

She could argue that the contract was void as contrary to fundamental public policy issues, if not actual law.

9. William Tackaberry was an agent of Weichert Realtors. Tackaberry contacted Thomas Ryan about the sale of his property and informed Ryan that he would receive a ten percent commission at the closing of such a sale. Despite extensive discussions and Tackaberry's efforts, Ryan never signed a letter that detailed the terms of the commission and contract for sale of the property. Ryan had sought to reduce the rate of commission, but Tackaberry refused to make any modifications. Meanwhile, Tackaberry negotiated and finalized a deal for the sale of the property, and Weichert sent Ryan a bill for ten percent of the purchase price, but Ryan refused to pay. Weichert then sued Ryan. Should Weichert recover and under what theory of contract law?

In this case, Weichert v. Ryan, 608 A.2d 280 (1992), the court held that Weichert could recover under the doctrine of quasi-contract. The court rejected Weichert's claim that an implied contract was created, because Ryan's conduct suggested that he did not agree to the terms submitted by Tackaberry. Substantial evidence proved that Tackaberry had obtained the deal, however, that the court found that justice required some compensation. Moreover, Ryan himself admitted that he had always intended to provide some compensation for the brokerage services. Consequently, Weichert is entitled to the fair value of its services, but not necessarily ten percent. This case was a relatively close call—a court might have reasoned that Weichert foolishly provided the services without first obtaining a contract and should bear the consequent risk.

10. Samuel Nichols, Inc., a brokerage firm, signed an exclusive brokerage agreement with Molway to find a purchaser for Molway's property within ninety days. Nichols would receive a commission for brokering a sale of the property within this time. Nichols began advertising the property and showing it to prospective buyers. Then, before the ninety days were up, Molway sought to cancel the agreement. Molway maintained that the

contract was unilateral, that Nichols had not yet performed its act (finding a buyer), so the contract could be canceled. Nichols disagreed. What sort of contract was this, and did Molway lawfully cancel the contract?

In this case, Samuel Nichols, Inc. v. Molway, 515 N.E.2d 598 (1987), the court held that the contract was bilateral. The court reasoned that Nichols had promised to use its best efforts to market the property in exchange for Molway's promise to give a ninety-day exclusive arrangement. Thus, the contract was binding for ninety days. Even if the contract had been deemed unilateral, the court might still have ruled for Nichols, because that company had acted in justifiable reliance on Molway's promise.

Further Readings

Basic Readings

West's Business Law, Sixth Edition, Clarkson, Miller, Jentz, and Cross (1994), Chapter 11 — This chapter of the university business law text addresses the nature and terminology of contracts

Contracts in a Nutshell, Gordon D. Schaber and Claude D. Rohwer (3d ed., 1990), Chapters 1 and 3 — These chapters of the simplified legal guide provide an introduction to the basis of contracts and discuss the law of quasi-contract.

Intermediate Readings

Corbin on Contracts, Arthur Linton Corbin (1963), Chapter 1 — This chapter of the multivolume treatise discusses critical definitions used in contract law.

Contracts, John D. Calamari and Joseph M. Perillo (2d ed. 1977), Chapter 1 — This chapter of the hornbook addresses types of contracts and philosophical foundations of contract law

Advanced Readings

Restatement of the Law (Second) of Contracts, American Law Institute (1979), Chapter 1 — These sections of the official review of American contract law discuss the meaning of contract law terms.

Jay M. Feinman, "The Last Promissory Estoppel Article," 61 *Fordham Law Review* 303 (1992) — This article questions the continued validity of promissory estoppel in light of new contract theories.

Lecture Two

Offer and Acceptance

Scope: The first element of a legally binding contract, the agreement, is composed of both an offer and an acceptance. The terms of the offer should be fairly definite, and the acceptance should be unambiguous. Negotiations between offeror and offeree should be conducted in accordance with the Uniform Commercial Code, and the “reasonable person” is brought in to the picture to give a rational perspective on the proceedings.

Outline

- I. The Offer.** A contract requires first an offer, which has several requirements.
 - A. Serious Intention to Be Bound.** To constitute an offer, a statement must sound like such an offer to the reasonable listener. Statements made in jest or out of anger are not offers that can be accepted. Nor are advertisements or preliminary negotiations legal offers.
 - B. Definiteness.** To constitute an offer, the statement must have reasonably definite terms. Thus, it should generally specify the consideration. Vague promises like a "reasonable share of the profits" are not offers.
 - C. Communication.** An offer must be communicated to the offeree to be effective.
 - D. Termination.** After an offer is made, the offeree may accept, unless the offer has been terminated.
 - 1. Revocation.** The person who makes an offer may revoke that offer any time prior to acceptance. The exceptions to this rule are option contracts and certain offers by merchants who promise to hold them open.
 - 2. Rejection or Counteroffer.** If the offeree rejects the offer or makes a formal counteroffer, the original offer terminates.
 - 3. Operation of Law.** Offers are terminated by law after a certain lapse of time (depending on the circumstances of the offer), the destruction of the subject matter of the offer, and other factors.
- II. The Acceptance.** Once an offer is accepted, it becomes a contract that is binding upon both parties.
 - A. Method of Acceptance.** Any offer can be accepted by any method reasonable in light of the offer.
 - B. Serious Intention to Accept.** Like the offer the acceptance must be clear and unambiguous.
 - C. Communication.** An offer is not effective until it is communicated to the offeror.
- III. Acceptance Varying from the Offer.**
 - A. Mirror Image Rule.** Under the traditional common law, the offeror could only accept the offer exactly as it was presented. One could not both modify and accept another's offer.
 - B. U.C.C. § 2-207.** Under the U.C.C., an acceptance may slightly modify the offer and still produce a contract. Contemporary business takes place with purchase orders and confirmations, which often contain different terms. If the parties fundamentally intend to contract and do not intend to insist upon their own terms, then a contract exists, even if the offer and acceptance are not identical. If the acceptance contains additional terms, they become part of the contract, unless the offeror promptly rejects them or they materially transform the offer. If the acceptance terms conflict with the offer, courts use the general U.C.C. rules as a default position.
- IV. When Acceptance Takes Effect.** Although acceptance requires communication, it is effective before it reaches the offeror. An acceptance is effective and creates a binding contract as soon as it is dispatched by reasonable means.

Review Questions

1. Janet offers an award for capture of her husband's murderer. Unaware of the reward, Cecille captures the murderer. Is Cecille legally entitled to the reward?

No, because the reward offer was not communicated prior to acceptance.

2. On January 1, Maurice sends Joel an offer, which is received on January 4. On January 3, Maurice sends a revocation of the offer, which was received on January 6. Before receiving the revocation, Joel sent an acceptance on January 5. Do Joel and Maurice have a binding contract?

Yes, the acceptance was effective on the 5th and formed a contract, and the revocation did not become effective until its receipt, which was on the 6th and too late because acceptance had already occurred.

3. What are the legal requirements for an offer that may be accepted to form a contract?

A serious intention to be bound, reasonable definiteness of terms, and communication to the offeree

4. A buyer made a low offer to a car dealer, who rejected it. After extensive discussions, the dealer decided to accept the original offer, but now the buyer wants no deal. Can the dealer accept the offer?

No, the earlier rejection terminated the offer, which could no longer be accepted.

5. Juan offered to sell real property to Julia and promised her she would have a thirty-day exclusive option on the property. After a week, Juan informed her that her time to accept was up. Can Julia insist on the full thirty days to decide?

No, not unless she paid for the thirty-day option. The offeror controls the offer and can revoke at any time, regardless of a contrary promise.

6. Maggie seeks to buy land from Chris, who declares that he would not consider selling for less than \$55,000. Maggie then states that she accepts at that price. Do they have a contract to transfer the land?

No, because Chris's statement constitutes preliminary negotiations and does not sound as an offer.

7. Under common law contracts for services, must the offeree accept the precise terms of the offer and why?

Yes, the offeree cannot accept and modify terms under the common law's mirror-image rule.

8. Ruth Ann offers Ed a job at minimum wage but agrees to sweeten the pot with a "fair share of the profits" if he does a good job. The business is successful, but Ruth Ann refuses to share the profits. Can Ed successfully claim a share of the profits?

No, because the phrase "fair share" is insufficiently definite and offers a court no method for determining the remedy.

9. The Changs read an advertisement from First Colonial Bank regarding saving certificates. The advertisement stated that a depositor could deposit a certain amount, receive a gift, and receive a certain amount at the certificate's maturity in three and one half years. The Changs made a deposit of \$14,000 as the advertisement specified, and they received the promised gift. After maturity, however, the bank gave them only \$18,823, rather than the \$20,136 promised in the advertisement. First Colonial explained that the advertisement contained a typographical error, so that a \$15,000 investment was required to receive the greater sum. The Changs filed suit to recover the difference, claiming that the parties had a binding contract. Explain whether the Changs should prevail on this claim.

In this case, Chang v. First Colonial Savings Bank, 410 S.E.2d 928 (1991), the court ruled for the Changs. Although an advertisement ordinarily does not constitute an offer that can be accepted for a binding contract, in this instance the advertisement was clear, definite, and explicit. The court also emphasized that the bank had not informed the Changs about the typographical error until after it had used their money for more than three years. In these circumstances, the court would hold the bank to fulfill the terms of the advertisement.

10. Marino Consultants sent Delpaq Computer Corporation a purchase order for 100 computers at the advertised price, and this order made no mention of warranties. Delpaq responded with a confirmation that accepted the order and contained detailed terms, including one that stated that the company made "no warranties of any kind." Marino representatives did not closely read the corporation and did nothing further. Soon after the purchase, twenty of the computers suffered major hard drive failures. Marino sought to recover damages, but Delpaq sought to rely on the absence of warranties. Did the parties have a contract, and if so, what are its terms?

Although Delpaq's confirmation contained additional terms, this fact does not make it a counteroffer. Assuming that the parties intended to make a deal, there is a contract. The additional terms, including the disclaimer of warranties, presumptively become part of the contract, since Marino did not promptly object. However, such additional terms do not become part of the contract if they make a material alteration in the offer. Elimination of all warranties is so substantial that it would probably be held to be such an alteration, so the disclaimer would not become part of the contract. Thus, the contract contains no warranty term, but Marino may rely on the implied warranties contained in the Uniform Commercial Code.

Further Readings

Basic Readings

West's Business Law, Sixth Edition, Clarkson, Miller, Jentz, and Cross (1994), Chapter 12—This chapter of the university business law text covers the requirements of contract agreement.

Contracts in a Nutshell, Gordon D. Schaber and Claude D. Rohwer (3d ed. 1990), Chapter 2—This chapter of the simplified legal guide addresses the rules for contract formation.

Intermediate Readings

Corbin on Contracts, Arthur Linton Corbin (1963), Chapters 2-4 — These chapters of the multivolume treatise discuss offer and acceptance.

Contracts, John D. Calamari and Joseph M. Perillo (2d ed. 1977), Chapter 2 —This chapter of the hornbook addresses the law of offer and acceptance.

Advanced Readings

Restatement of the Law (Second) of Contracts, American Law Institute (1979), Chapter 3 —This chapter of the official review of American contract law addresses the law of offer and acceptance.

Avery Katz, *The Strategic Structure of Offer and Acceptance: Game Theory and the Law of Contract Formation*, 89 Michigan Law Review 215 (1990) —This article calls for reconsideration of traditional doctrine in light of contemporary developments.

Lecture Three

Consideration, Capacity, and Form

Scope: Consideration is the heart of a contract; it refers to the goods, services, or even inaction to be exchanged between the contracting parties. As such, the rules of contract law are both involved and explicit. There are several exceptions and modifications to these rules, however, which occur when minors are contracting parties, or when there is another limitation on the capacity of one party.

Outline

I. Consideration.

- A. **Detriment.** Consideration necessarily involves the parties giving up something, called a detriment. The thing given up must have legal value but need not have financial value and need not be tangible.
- B. **Bargained For.** The detriments sacrificed by each party must be bargained for. This means that there must be an exchange of detriments and not simply simultaneous gifts.
- C. **Pre-Existing Duty Rule.** Doing something that a party already had a legal duty to perform is not consideration. The party has given up nothing over and above the status quo. However, the U.C.C. abolishes the pre-existing duty rule for contracts in goods, so a party may successfully ask for a contract modification without additional consideration.
- D. **Illusory Consideration.** The consideration must be binding and not avoidable by unilateral action.
- E. **Adequacy of Consideration.** While some consideration is required, courts do not examine the adequacy of each side's consideration or the fairness of the bargain.
- F. **Exceptions to Consideration Requirement.** There are some limited exceptions to consideration. Thus, a promise to pay a debt that has been barred by the statute of limitations is binding without additional consideration.

II. Capacity.

- A. **Minors.** Minors are those under eighteen years of age. Note that parents are not liable for their children's contracts unless they co-sign.
 - 1. **Ordinary Contracts Voidable.** If a minor makes a contract, the minor may void it and escape his or her obligations and need only return the consideration in its present form.
 - 2. **Necessaries.** If a substance is a "necessary" for the minor (e.g., contracts for a business run by the minor), the minor may still disaffirm and avoid the contracts but must return the full value of the consideration at the time of the contract.
 - 3. **Ratification.** A minor may bind himself or herself to a contract by ratifying it (or not disaffirming it) after the minor comes of age.
 - 4. **Lying About Age.** If the minor affirmatively lied about his or her age, many states require payment of the full value of the consideration upon disaffirming.
- B. **Intoxication.** An intoxicated party lacks capacity but only if the intoxication was so severe that the party did not know what it was doing.
- C. **Mental Incapacity.** Again, only severe cases permit voiding a contract.

III. Statute of Frauds.

Under the statute of frauds, some types of contracts must be in writing or memorialized in a writing to be binding

- A. **Land Sales.** Sales of land, including long-term interests in land must be in writing.
- B. **Sale of Goods.** Under the U.C.C., the sale of goods for more than \$500 must be in writing.
- C. **One Year Rule.** Contracts that by their terms cannot conceivably be performed within one year must be put in writing. There are also a few other limited applications of the statute of frauds.

Review Questions

1. An employer states that in exchange for an employee's decades of service, the employer will give her a \$5000 bonus but then changes its mind the next day. Is there a contract for the bonus?

No, because the employee provided no consideration—the decades of work were all in the past and not bargained for.

2. Sam claims that Frasier owes him \$10,000 in bar tabs, but Sam has no records and Frasier disputes the amount. Frasier offers to pay \$5000 in full payment. After accepting the money, Sam sues for the remaining \$5000, but Frasier claims they had a contract limiting the debt. Is Frasier correct?

Yes, because the amount owed was in dispute (unliquidated), the compromise has consideration and is a binding contract to settle for \$5000.

3. When is a person fully bound by contracts entered as a minor?

Only in cases of ratification after reaching the age of majority. In cases of necessities or lying about age, the minor's disaffirmation is limited by the requirement of return of full consideration, however.

4. Petro has a contract with Araco to purchase gasoline in bulk at eighty-five cents per gallon for the next year. After an international crisis, crude oil prices double. Araco asks Petro to pay one dollar per gallon and Petro agrees. Petro later tries to hold Araco to the original eighty-five-cent deal. What is the legal price for the gasoline?

The dollar- per-gallon price is enforceable. Petro agreed to modify the contract, and additional consideration is not required under the U.C.C.

5. Harmon had an agreement to provide accounting services at \$150/hour for the next year. After he becomes famous in mid-year, his clients agree to pay \$250/hour. At the end of the year, a client pays only \$150/hour for Harmon's service. Is Harmon entitled to the additional \$100/hour.

No, because he offered no additional consideration for the increased contract price and this services contract is not governed by the U.C.C.

6. Max bought a motorcycle while still a minor but continued to make several months payments after becoming eighteen. Is the contract now binding?

Yes, the continued payments will be deemed an implied ratification of the deal.

7. A company makes a contract to purchase all the "wood required by my business in 1995." Is this consideration illusory?

No, this is a binding requirements contract, because it extends to all the wood "required" rather than all the wood "desired." If the company buys any wood, it can only be from the contract party.

8. Gihann promises to work for Rob "for the rest of my life." Must this contract be in writing to be enforceable?

No, because she theoretically might die within one year, the contract may be oral.

9. Rivendell Forest Products developed a computer program that enabled it to quote prices much faster than could its competition. Rivendell then told all of its employees, including Timothy Cornwell, to sign a confidentiality agreement promising to keep the program secret from all of its competitors. Cornwell subsequently left Rivendell to work for a competitor, Georgia-Pacific Corp., and he introduced the price quote program at Georgia-Pacific. Rivendell sued Cornwell for breach of the confidentiality agreement, but he claimed that there was no binding contract. Did Cornwall breach a binding agreement?

In this case, Rivendell Forest Products, Ltd. v. Georgia-Pacific Corp., 824 F. Supp. 961 (D.Colo. 1993), the court held that there was no contract, because Rivendell gave no additional consideration in exchange for the confidentiality agreement. This is a close case, as the court might have reasoned that Rivendell's consideration

was in continuing to employ Cornwell (though this would depend on the terms of his employment agreement). Rivendell also has a possible claim for breach of trade secret or some other contract theory for recovery.

10. John Polachek received a life insurance policy through his employer and named his niece, April Iverson, as beneficiary. April was eleven years old when Polachek died. The insurer, Bankers Life and Casualty, was unaware of her minor status and mailed her a \$10,000 death benefit check. April's father had her sign the check over to him and he then misappropriated the money. April subsequently filed suit against Bankers to recover the money. In response to the company's claim that she had endorsed the check, she argued that she did not have capacity to discharge the contractual obligation. Does Bankers remain liable to April?

In this case, Iverson v. Scholl, Inc., 483 N.E.2d 893 (1985), the court held for April. The court held that minors were not bound by contracts and that the other party's ignorance of the minority does not alter this rule. Although Bankers had already made payment in good faith, the court held that April could disaffirm her endorsement and made Bankers liable to her for an additional \$10,000.

Further Readings

Basic Readings

West's Business Law, Sixth Edition, Clarkson, Miller, Jentz, and Cross (1994), Chapters 13, 14, and 16 — These chapters of the university business law text address issues of consideration, capacity, and the statute of frauds.

Contracts in a Nutshell, Gordon D. Schaber and Claude D. Rohwer (3d ed. 1990), Chapter 4 and pp. 74-110 — These sections of the simplified legal guide address the Statute of Frauds and rules on consideration and capacity.

Intermediate Readings

Corbin on Contracts, Arthur Linton Corbin (1963), Chapters 5-11 and 12-23 — These chapters of the multivolume treatise discuss consideration and the Statute of Frauds.

Contracts, John D. Calamari and Joseph M. Perillo (2d ed. 1977), Chapters 4, 8, and 19 — These chapters of the hornbook address consideration, capacity, and the Statute of Frauds

Advanced Readings

Restatement of the Law (Second) of Contracts, American Law Institute (1979), Chapters 2, 4, and 5 — These chapters of the official review of American contract law address capacity, consideration, and the Statute of Frauds.

Melvin John Dugas, "The Contractual Capacity of Minors: A Survey of the Prior Law and the New Articles," 62 *Tulane Law Review* 745 (1988) — This article thoroughly reviews the law of minors' capacity.

Lecture Four

Genuineness of Assent

Scope: Stringent as the law may appear in forcing the execution of contracts, it is equally rigorous in determining the validity of each element of such an agreement. The assent to participate in a contractual agreement is essential to its validity, and this lecture covers the conditions under which assent can be considered invalid. Mistake, fraud, and duress are among those circumstances which can void a contract, much to many people's relief!

Outline

- I. **Mistake.** Under some circumstances, a contract may be avoided because one or both parties was laboring under a material mistake of fact.
 - A. **Mutual Mistake.** A contract may be voided if both parties are mistaken under the following circumstances:
 - 1. **Fact.** For a mistake to invalidate a contract it must be a mistake of fact. A mistake about value or about future events will not make a contract voidable.
 - 2. **Basic Assumption of Contract.** The mistaken fact must involve a basic assumption of the contract, such as the nature of the consideration. It cannot be ancillary to the contract, and mistakes about financial conditions or ability to pay do not qualify.
 - 3. **Allocation of Risk.** If the parties have recognized the risk of mistake and allocated that risk, such a party cannot seek to escape the contract. This includes a compromise of conscious ignorance, when the parties recognize that they do not appreciate all the underlying contractual facts.
 - B. **Unilateral Mistake.** If only one party to the contract is mistaken, there are additional conditions before voiding a contract. In addition to the above requirements, the mistaken party should demonstrate that the nonmistaken party knew or should have known of the presence of the mistake.
- II. **Fraud.** A party can void a contract if the other party committed fraud in negotiating the contract, and the following conditions are met.
 - A. **Misrepresentation of Fact.** Fraud means that the defendants have made a misrepresentation, an untruth, and this misrepresentation must be one of fact, not value. A seller is allowed a certain amount of "puffing" or exaggerating the subjective qualities of a product. An omission or silence may constitute fraud in some circumstances, such as when there is a special relationship of reliance between the parties.
 - B. **Knowledge.** To constitute fraud the misrepresentation must be knowing or intentional. An accidental, unknowing misrepresentation is not fraud, though it may form the basis of mistake.
 - C. **Justifiable Reliance.** The allegedly defrauded party must have relied on the misrepresentation, and this reliance must be justifiable under the circumstances.
 - D. **Damages.** The plaintiff must show that it was damaged by the misrepresentations.
- III. **Duress.** Parties are not bound to contracts that they are forced to sign at gunpoint. A gun is not required, though, and other forms of coercion may constitute duress. Even extreme economic pressure may constitute duress.
- IV. **Undue Influence.** Extremely unfair persuasion may void a contract just as coercion. Persuasion is ordinarily unfair only in the presence of a special relationship of trust between the parties.
- V. **Unconscionability.** Although courts do not ordinarily void bad deals made by parties, some contracts may be so very unfair that a court will not enforce them.
 - A. **Contract of Adhesion.** This is a form contract with non-negotiable terms. Such contracts are common and not unlawful, but the presence of such a contract is a factor in defining unconscionability.

- B. Disparity of Bargaining Power.** One party to a contract may have a much stronger bargaining position and take advantage of that fact. An unconscionable contract usually involves a large and powerful institution contracting with a disadvantaged individual.
- C. Extremely Unfair Terms.** Courts consider whether the contract terms are far different from those in comparable transactions between more equal parties.

Review Questions

1. When a price quotation in an offer is far too low because of a calculation or typographical error, will the offeror be bound by the terms of the offer?

Not necessarily, if the party receiving the offer knows or should know of the presence of the mistake or if the offeree has not yet relied upon the mistake.

2. JoAnn agrees to purchase a used piano from Meg for two hundred dollars but they subsequently discover that the piano is worth thousands of dollars. Can JoAnn escape the contract on grounds of mutual mistake?

No, because any mistake involves a matter of value and not fact.

3. Under what if any circumstances may a statement of opinion form the basis for a successful fraud claim?

If the statement is made by an expert in the field who should know to the contrary, even a false statement of opinion may constitute fraud.

4. Gomez meets a salesman on the streets of New York, who offers Gomez a "genuine gold Rolex watch" for thirty-five dollars. After purchasing the watch, Gomez discovers that it is not authentic. Can Gomez successfully maintain a fraud claim against the sidewalk salesman?

Probably not, because Gomez could not justifiably have relied upon such an implausible offer.

5. Graham parks his car in a garage and receives a ticket stub stating on the back that the company is not liable for any damages to the automobile. After an employee wrecks the car on a joy ride, Graham sues the parking garage company. Can he recover, notwithstanding the disclaimer?

Graham can almost certainly recover, as the contract disclaimer will be deemed unconscionable.

6. Lisa threatens to sue Amy on a past due debt unless Amy agrees to sign a contract to buy restaurant supplies from her. After agreeing, Amy tries to escape the latter contract and alleges duress. Is Amy bound to the restaurant supplies deal?

Yes, because a threat to sue on an existing debt might be considered leverage but does not rise to the level of economic duress.

7. Joseph sells his used car to William, who noted that the odometer read only 33,000 miles. Joseph had not mentioned that the odometer had broken four years earlier and stuck at that level. William sues Joseph for fraud. Should William succeed?

Yes, because this is an instance when silence may constitute fraud.

8. Under what circumstances will a contract be voidable for exercise of undue influence?

The key is a special relationship between the parties, but courts also consider the overall fairness of the contract, agreement in an unusual time or place, and a rush to decision without any third-party advice.

9. William and Lilly Adams divorced in 1985. They voluntarily divided their property and reached a settlement. She subsequently challenged this settlement agreement, because Mr. Adams told her that the deal was fair and that she must take the property and not seek alimony. He threatened to declare bankruptcy and to make her liable for his debts if she did not agree. She had spoken to two attorneys about the settlement, but both sought time to review the agreement, and she instead went ahead and signed. Ms. Adams seeks to escape the settlement agreement on grounds of fraud and duress. Is the settlement binding?

In this case, Adams v. Adams, 503 So.2d 1052 (1987), the court held that the divorce settlement was binding. There was no fraud because she could easily have retained an attorney to investigate the circumstances but she failed to do so. The bankruptcy threat was neither fraud nor duress. First, their assets substantially exceeded their liabilities, so there was no credible possibility of a bankruptcy declaration. Second, if the circumstances would have supported bankruptcy, this would have been a perfectly valid action that would not constitute duress.

10. Steven Lanci had an automobile accident with an uninsured motorist. When he approached his insurance company, Metropolitan Insurance Co., he told them that he had lost the copy of his insurance policy. Metropolitan suggested that his policy limits were \$15,000, so Lanci agreed to accept this amount for his injuries in a settlement agreement. He subsequently discovered that the policy limits were actually \$250,000 and sought to void the settlement agreement for the lesser sum. What is Lanci's best argument for voiding the settlement and should the court do so?

In this case, Lanci v. Metropolitan Insurance Co., 564 A.2d 972 (1989), the court held that the original settlement agreement was void, because of mutual mistake of material fact. Apparently, both parties believed that the policy limits were only \$15,000, which was a mistake. Lanci might have tried to recover in fraud, but this would have been a shakier case. First, he would have to prove that Metropolitan knowingly misrepresented the policy limits. Second, Lanci might have had trouble proving justifiable reliance on the statement, given his own ability to investigate the policy limits.

Further Readings

Basic Readings

West's Business Law, Sixth Edition, Clarkson, Miller, Jentz, and Cross (1994), Chapter 15 — This chapter of the university business law text addresses issues of genuineness of assent.

Contracts in a Nutshell, Gordon D. Schaber and Claude D. Rohwer (3d ed. 1990), Chapter 7 — This chapter of the simplified legal guide addresses contract defenses affecting assent.

Intermediate Readings

Corbin on Contracts, Arthur Linton Corbin (1963), Chapters 27-29 — These chapters of the multivolume treatise discuss mistake as a contract defense.

Contracts, John D. Calamari and Joseph M. Perillo (2d ed. 1977), Chapter 9 — This chapter of the hornbook addresses avoidance or reformation of contracts for misconduct or mistake.

Advanced Readings

Restatement of the Law (Second) of Contracts, American Law Institute (1979), Chapters 6 and 7 — These chapters of the official review of American contract law address mistake, misrepresentation, duress, and undue influence.

Trudy Nobles Sargent, "Unconscionability Redefined: California Imposes New Duties on Commercial Parties Using Form Contracts," 35 *Hastings Law Journal* 161 (1983) — This article reviews a recent development in California law of unconscionability.

Hoffman F. Fuller, "Mistake and Error in the Law of Contracts," 33 *Emory Law Journal* 41 (1984) — This article reviews the evolution of the law of mistake in contract and its implications.

Lecture Five

Performance and Discharge

Scope: Once a binding contract has been established between parties, the effective performance of the requirements of that contract should occur. There are several components of such performance, and the law covers the consequences of partial, delayed, and conditional performance in great detail. There are a few circumstances under which binding contracts can be excused, but the law is very strict in this regard.

Outline

- I. Performance.** When one has a binding contract, the presumptive duty is to perform the requirements of that contract.
 - A. Perfect Performance.** If a party precisely and perfectly performs all contractual obligations, the contract is discharged and the party is entitled to receive payment.
 - B. Substantial Performance.** If performance is not exactly as promised, the contract may still be discharged for substantial performance if actual performance is near to what the contract provided. By contrast, a material breach is when performance falls far short of the contractual promise. Several factors go into defining substantial performance.
 - 1. Percentage Completion.** If a party completes a high percentage of the promised performance, it will be substantial, though the other party may get damages for the shortfall.
 - 2. Degree of Benefit.** Even a high percentage completion may not be substantial performance if the other party does not get a proportionate high degree of benefit from such performance.
 - 3. Personal Satisfaction Contracts.** Some contracts, particularly for art and other aesthetic objects, require personal satisfaction of the recipient for performance, though the recipient must use good faith.
 - C. Delay in Performance.** If a party's performance is late, that performance is still generally considered substantial performance, unless time was known to be of the essence of the contract
 - D. Sales Contracts.** The U.C.C. provides some special rules for performance of contracts for the sale of goods. The Code requires perfect tender of the goods but requires that the seller be given an opportunity to cure any defects.
- II. Conditions.** Contracts may be subject to a condition that will discharge the entire contract if the condition fails.
 - A. Express Conditions.** These are contracts stated in the contract that must occur (or not occur) for the contract to be binding. These conditions must be fulfilled exactly; there is no substantial performance of a condition. Most contract terms are considered promises or specifications rather than conditions.
 - B. Constructive Conditions.** The law imposes certain constructive conditions on nearly all contracts, such as a covenant of good faith on the parties.
 - C. Excuse of Conditions.** The failure of a condition may be excused, thereby rendering the contract valid. This can occur by waiver of the parties or if one party hindered the occurrence of the condition.
- III. Impossibility.** Contracts are discharged if they become impossible to perform. This is determined by a strict objective standard, however.
- IV. Impracticability.** Contracts are also discharged if performance becomes economically impracticable, though this requires an extreme and unforeseeable increase in costs, not merely unprofitability.
- V. Frustration of Purpose.** Contracts may be discharged if some external event unforeseeably frustrates the known purpose of the contract such that a party would not receive a benefit.
- VI. U.C.C. Sales Requirements.** In a goods contract governed by the U.C.C., the seller is supposed to deliver goods conforming to the contract at the time and place specified or at a reasonable time and place. If the goods are nonconforming, the buyer must inform the seller within a reasonable time, after opportunity for inspection. The seller must then be given an opportunity for timely cure of the defects.

Review Questions

1. A winemaker has a large vat that was damaged and suffered fifteen punctures. The repair company fixes fourteen of these and seeks payment under the contract. Is this substantial performance?

Not necessarily, this is a case when a high percentage of completion would not provide the other party with much benefit, if all the wine ran out the one remaining hole in the vat.

2. Leonard agrees to buy a house subject to his ability to obtain financing. After changing his mind, Leonard makes no effort to get financing, and the seller complains. Is the contract nevertheless discharged for failure of a condition?

No, Leonard must make a good faith effort to obtain financing in order to rely on this condition in order to escape the contract.

3. A large computer maker has a contract to deliver several hundred machines to a retail store company. A flaw is found in the chips supplied by a third party for use in the computers. Does this flaw discharge the contract?

Probably not. In theory, such a flaw could frustrate the purpose of the contract or make it economically impracticable. In actuality, the flaw would have to be quite substantial to invoke one of these doctrines.

4. A band had a contract with a club for performance, but an electrical inspector finds the club cannot admit customers. Must the club pay the band under the contract?

No, because of frustration of purpose.

5. Cohen Construction Co. has a contract to build offices on a certain lot. After nearly completing the task, the office building burns. Does this discharge the contract for impossibility?

No, because it is still possible for Cohen to fulfill the contract simply by starting over.

6. CBS has a contract to televise the World Series and agrees to pay a certain sum. The baseball players go on strike, but the teams use replacement players and go forward with the World Series. Does CBS remain bound by the contract?

This probably depends on other facts. CBS could argue that the presence of major league players was an express or implied condition on their contract. Resolution of this would require examining the language of the precise contract. They might also try to argue frustration of purpose, and this depends on the degree of frustration and the foreseeability of the strike.

7. Herman contracts to mow your lawn on Thursday. When he does not show up, you mow it yourself on Friday morning. Then Herman shows up on Friday afternoon. Must you pay him for mowing the yard?

Yes, unless you had given him some reason to know that time was of the essence for this job.

8. After you agree to purchase a new car on special order, can you reject the delivered car because the interior speakers do not match the promised specifications?

No, if this is the only flaw the performance would be considered substantial. If the speakers are particularly important to you, you should make it a condition of the contract.

9. Sun Maid Raisin Growers signed a contract to buy nearly two thousand tons of raisins from Victor Packing Co. Victor was planning to buy the raisins late in the year, which normally meant that it could get a better price. In this particular year, however, much of the crop was destroyed by heavy rains, and the price was about twice the normal level. Victor could not fulfill the contract with Sun Maid without suffering substantial losses, selling at a lower price than they would have to pay for the raisins. Sun Maid refused to renegotiate the price, so Victor sought to avoid the contract for impracticability. Should Victor succeed?

In this case, Sun Maid Raisin Growers v. Victor Packing Co., 194 Cal. Rptr. 612 (1983), the court held against Victor. The possibility of crop failures or fluctuating prices was well known to Victor at the time of the contract. Victor took a risk by waiting until late in the season to contract for raisin supplies and thereby themselves took the risk of price increases. Victor also could have purchased insurance to protect itself. Having failed to do so, Victor must accept the consequences.

10. The Jacobs contracted with Eugene Plante to construct a house on their lot for a little over \$26,000. During construction, Plante was paid \$20,000. The parties disputed several matters, and Plante refused to do any further work on the house. The Jacobs then contended that Plante had not performed because there were cracks in the house, a wall had been misplaced, there were no kitchen cabinets and other factors. Plante sought the remaining \$6000, but the Jacobs sought to recover the \$20,000 already paid. How should the court rule?

In this case, Plante v. Jacobs, 103 N.W.2d 296 (1960), the court held that Plante had substantially performed the contract and was entitled to some payment. He was not entitled to the full \$6000 remaining under the contract, however. The plaintiffs could deduct the cost of repairing certain flaws, such as the cost of installing kitchen cabinets. The plaintiffs could not reduce payment for the costs of moving the wall, but could reduce the payment for any reduction in the house's value for the misplaced wall.

Further Readings

Basic Readings

West's Business Law, Sixth Edition, Clarkson, Miller, Jentz, and Cross (1994), Chapter 18 — This chapter of the university business law text addresses issues of performance and discharge.

Contracts in a Nutshell, Gordon D. Schaber and Claude D. Rohwer (3d ed. 1990), Chapters 9 and 13 — These chapters of the simplified legal guide deal with issues of performance and excuse and discharge.

Intermediate Readings

Corbin on Contracts, Arthur Linton Corbin (1963), Chapters 67-78 — These chapters of the multivolume treatise discuss the law of discharge and impossibility.

Contracts, John D. Calamari and Joseph M. Perillo (2d ed. 1977), Chapter 21 — This chapter of the hornbook addresses discharge of contracts.

Advanced Readings

Restatement of the Law (Second) of Contracts, American Law Institute (1979), Chapters 10 and 11 — These chapters of the official review of American contract law address laws of performance, impracticability, and frustration of purpose.

Sheldon W. Halpern, "Application of the Doctrine of Commercial Impracticability: Searching for 'The Wisdom of Solomon,'" 135 *University of Pennsylvania Law Review* 1123 (1987) — This article addresses the problems of defining when commercial impracticability should discharge a contract.

Lecture Six

Remedies

Scope: In the event of a breach of contract, what compensation can the non-breaching party be awarded? There are several methods by which the remedy can be estimated in financial terms, but most cases are settled by awarding damages. Calculation of damages is in itself a complicated art, the foundations of which are laid out here. In addition to strict financial compensation, some cases are settled by awarding injunctions or other equitable remedies.

Outline

- I. Damages.** The law presumes that the remedy for most contract breaches is money damages for losses attributable to the breach. There are several different measures of damages.
 - A. Expectation.** The presumptive measure of damages is called expectation damages, which are to put the parties in the position they would have been in had the contract been performed as promised.
 - 1. Calculation.** In most business contracts, expectation damages are measured by lost profits. In other contracts, damages are measured by comparing the value of the actual performance with that of the promised performance.
 - 2. Reasonable Certainty.** Expectation damages can be recovered only if they can be identified with reasonable certainty. This may not be possible when damages are contingent on public ticket sales or other unpredictable factors.
 - 3. Foreseeability.** A party can only recover those expectation damages that were reasonably foreseeable to the other party.
 - 4. Mitigation.** Once one party has breached the contract, the other party must mitigate its damages and try to limit damages as much as possible. In a contract for goods, the party generally must "cover" by purchasing goods from another source and then recovering the cost difference.
 - B. Reliance.** If expectation damages are unavailable, the party may recover reliance damages. These damages restore the party to the positions they were in prior to entering the contract. If a party makes expenditures in reliance on the other's performance, those costs may be recovered in reliance damages.
 - C. Restitution.** Restitution damages enable the non-breaching party to recover payments made under the contract to the breaching party.
 - D. Liquidated Damages.** When a contract specifies the amount of damages to be paid for a breach, that is called liquidated damages. Liquidated damages may be used when expectation damages may be difficult to calculate because of uncertainty but cannot be used as a penalty for breaching a contract.
 - E. U.C.C. Sales Contracts.** Additional rules for remedies apply under the U.C.C..
 - 1. Buyers' Rights.** If a seller breaches, the buyer has a right to cover by purchasing goods from an alternative source and recovering any increased cost. The cover goods need not be identical where impossible but should be as close as possible to the original goods.
 - 2. Sellers' Damages.** If a buyer fails to pay for goods, the seller's remedy is to recover the contract price. If the buyer refuses to accept conforming goods, the seller should try to find another buyer and can recover the difference for a lower price received from the new buyer.
 - F. Punitive.** Punitive damages, to punish the defendant, are generally unavailable in contract actions.
- II. Equitable Remedies.** Although damages are the presumed remedy for breach of contract, certain equitable remedies are sometimes available.
 - A. Specific Performance.** Specific performance implies an order requiring the other party to perform as promised under the contract. This is only available when damages are insufficient, as in the case of a unique, irreplaceable commodity. Specific performance is available for land sales but not to compel performance of personal service contracts.

B. Injunction. An injunction involves a court order prohibiting a party from acting in some manner. This may be used to enforce a contractual covenant not to compete, for example, by prohibiting an employee from establishing a competing business.

C. Rescission. This is simply an order rescinding the contract and allowing a party to escape its requirements. This might be used in cases of fraud or mistake.

III. Anticipatory Repudiation. A party may declare its intention not to perform under a contract well before performance is required. In this case, the other party may sue immediately or may choose to wait and see if the initial party might change its plans.

Review Questions

1. Linsly bought carpet from Bowen, a wholesaler, and resold it to her customers. After Bowen failed to deliver a carpet, Linsly's customer cancelled her order before Linsly could cover. What sort of damages can Linsly recover?

She could receive expectation damages, which would compensate for her loss of profit on the resale.

2. Stephanie agreed to buy land from Steve for \$55,000. He then refused to go through with the sale. He claimed that she suffered no damages, because the land was worth only the \$55,000 she had agreed to pay. What remedy does Stephanie have?

Because land is considered unique, Stephanie would have a right to specific performance to receive the land in question.

3. Jersey Farms had a contract to supply milk to a grocer. The grocer was short on cash and refused to accept delivery of the milk. Jersey dumped the milk cans outside the grocery delivery area for later pickup. The milk eventually spoiled. Jersey seeks to recover the entire contract price; can it?

Probably not. Once the grocer breached the contract and refused delivery, Jersey had a responsibility to mitigate damages by seeking another buyer. Unless such an alternative buyer were unavailable, Jersey cannot recover the entire contract price.

4. Under what circumstances should a party consider putting liquidated damages into its contracts?

Liquidated damages are useful whenever a party fears that it may have difficulty proving its actual damages after the fact, as in the case of the political candidate and television station.

5. What factors should a party consider in determining the amount of the liquidated damages put into a contract?

One obvious factor is the ability to get agreement from the other party. In addition, the party should take care not to make the liquidated damages unreasonable large, because a court may then consider the clause to be a penalty and refuse to enforce it.

6. What are the different types of damages available at law?

Expectation, reliance, and restitution.

7. An electronics wholesaler has a contract to purchase one hundred receivers for resale. The supplier is unable to deliver the receivers. What should the wholesaler do?

The wholesaler should not simply sue for damages but must first attempt to cover by purchasing the receivers from another source.

8. Michael was unlawfully fired from his job. In addition to his salary, he seeks damages for his transportation and other costs involved in trying to find a new job. Can Michael recover these costs even if he fails to find a new job?

Yes, the reasonable costs of seeking a new job are foreseeable, incidental damages associated with the unlawful firing.

9. Robin Griffin was a football coach for a professional team. He received a five year contract extension but was fired after two years. Because of the contract, he continued receiving payments though he was not coaching. After a year, he was approached by a major college team to become their coach. After he refused this offer, the professional team stopped making payments, claiming that he had refused to mitigate his damages for their breach of contract. Was Robin obligated to take the college coaching job or does he have a right to continued payments under the pro contract?

Robin probably was not required to accept the college job. He did have a duty to mitigate damages and consider other coaching opportunities. However, he need only take those opportunities that are deemed comparable with the professional job. Whether the college job was comparable depends not only upon pay but also prestige, other support, advancement opportunities, and perhaps quality of the team. Because a professional job is significantly different from a college job (e.g., recruiting responsibilities), they probably would not be considered comparable.

10. Hearts, Inc. is a major manufacturer of Valentine's Day candies. Hearts has a contract with Kitco to obtain the sugar necessary to manufacture the candies by January 15. Because of production problems, Kitco does not meet the delivery date and fails to provide the sugar until February 4. Hearts refuses the delivery because it was too late for production. Hearts has been able to cover and replace about twenty-five percent of the needed sugar from another company at the same price as Kitco offered. Given the shortfall, Hearts had to cancel its own sales contracts, and several purchasers indicated that they now considered Hearts unreliable and would take their future business elsewhere. Hearts seeks damages for its lost profits, its lost future contracts, and punitive damages. What can Hearts recover?

Kitco's breach entitles Hearts to some damages. Hearts receives no damages for the twenty-five percent covered, because the price was the same. Hearts receives its lost profits on the seventy-five percent of sales that it lost because of the lack of sugar. The right to recover for future sales is dubious. The existence of these sales and the size of the sales is rather speculative. Hearts might be able to recover if it could show a history of sales relationships in a reasonably certain amount that were lost because of Kitco's breach. Punitive damages are unavailable for breaches of contract.

Further Readings

Basic Readings

West's Business Law, Sixth Edition, Clarkson, Miller, Jentz, and Cross (1994), Chapter 19 — This chapter of the university business law text addresses issues of breach of contract and remedies.

Contracts in a Nutshell, Gordon D. Schaber and Claude D. Rohwer (3d ed., 1990), Chapter 8 — This chapter of the simplified legal guide discusses contract remedies.

Intermediate Readings

Corbin on Contracts, Arthur Linton Corbin (1963), Chapters 53-66 — These chapters of the multivolume treatise discuss the law of contract remedies.

Contracts, John D. Calamari and Joseph M. Perillo (2d ed., 1977), Chapters 14-16 — These chapters of the hornbook address damages, restitution, and specific performance.

Advanced Readings

Restatement of the Law (Second) of Contracts, American Law Institute (1979), Chapter 16 — This chapter of the official review of American contract law addresses contract remedies.

Robert Cooter and Melvin Aron Eisenberg, "Damages for Breach of Contract," 73 *California Law Review* 1432 (1985) — This article surveys the philosophical and economic foundations of the measure of contract damages.

Jeffrey B. Coopersmith, "Refocusing Liquidated Damages Law for Real Estate Contracts: Returning to the Historical Roots of the Penalty Doctrine," 39 *Emory Law Journal* 267 (1990) — This article reviews the standards for distinguishing penalties from liquidated damage clauses and argues for permitting such clauses.

Lecture Seven

Third-Party Rights

Scope: Under certain circumstances, a non-contracting party may have a stake in enforcing a contract. Such parties may indeed have a legal right to do so, if they are intended to benefit from the contract. Rights and responsibilities may also be transferred or delegated by an originally contracting party. In either case, the third party and the contract itself must meet several legal tests before such a case will be recognized by the court.

Outline

- I. Third-Party Contract Enforcement.** Most contracts are enforced only by the contract parties, but occasionally an outsider third party will desire to enforce a contract. The law recognizes several types of such third parties.
 - A. Incidental Beneficiaries.** An incidental beneficiary is a third party that simply happens to benefit from the contract for others. For example, a raw materials supplier would benefit from a construction contract. Incidental beneficiaries have no legal rights to enforce contracts as third parties.
 - B. Intended Beneficiaries.** Intended beneficiaries are those that the contracting parties intended to benefit, and they may sue to enforce these contracts.
 - 1. Creditor Beneficiaries.** One type of intended beneficiary is the creditor beneficiary. This type of beneficiary arises when two other parties contract to discharge a debt to the creditor beneficiary.
 - 2. Donee Beneficiaries.** A donee beneficiary arises when two other parties enter a contract with the express intent of benefiting a third party. One obvious example of this would be a life insurance contract naming a relative as beneficiary.
 - C. The "Shoe" Rule.** This rule means that the third party seeking to enforce the contract must "stand in the shoes" of the relevant contracting party. Thus, if one of the contracting parties committed fraud, the innocent third party's claim is subject to the fraud defense.
 - D. Contract Modifications.** When a third party has rights in a contract, she obviously also has an interest in any modifications to the contract that might be made by the parties. Such modifications to a contract may require the consent of the third-party intended beneficiary but not if the contract itself permits modifications without consent (as do most life insurance contracts).
- II. Assignments and Delegations.** These arise when a contracting party transfers contractual rights and responsibilities to another. Thus a company might sell its accounts receivable.
 - A. Assignments.** This is a contract granting a party rights in another contract, usually for consideration.
 - 1. Assignability.** The law presumes that a party can assign its rights in a contract but will not enforce assignments that would materially alter the duties of the other party to the original contract.
 - 2. Anti-Assignment Clauses.** Some contracts prohibit the assignment of their rights but this is effective only if there is some reason for the prohibition.
 - 3. Formal Requirements of Assignment.** Assignments are like other contracts and require the same elements, except that the law may enforce gratuitous assignments (without consideration) if notice is given.
 - 4. Rights of Assignee.** The assignee may sue to enforce the contract just as could the original party, though the "shoe rule" also applies here
 - 5. Notice.** A problem may arise if a party assigns the same contractual rights more than once. In most states, the first assignee has the rights, though in some states the rights go to the first to give notice of the assignment.
 - B. Delegations.** The converse of an assignment, when a contracting party pays someone else to assume the duties of contractual performance.
 - 1. Delegability.** Duties can only be delegated if doing so would not materially alter performance under the contract.

2. **Delegatee Liability.** If the person receiving the delegation fails to perform, he or she may be sued just as if a party to the original contract.
3. **Delegator Liability.** If the person receiving the delegation fails to perform, the original contract party making the delegation also remains liable under the original contract.

Review Questions

1. As a Christmas present to his parents, Rob hires a painter to repaint their house. If the painter fails to show up, may the parents sue to enforce the contract?
Yes, they are intended donee beneficiaries.
2. Oliver Stone, a movie director, obtains a contract from MGM Studios to film a movie starring the actor Tom Cruise. Stone then changes his mind and casts a different actor in the lead role. Can Cruise sue to enforce the original contract?
No, Cruise is only an incidental beneficiary.
3. Under what circumstances can the parties change their contract to name a new person as a donee beneficiary?
When the contract grants them the rights to make such modifications or if the change is made before the original beneficiary has relied upon the original contract.
4. Sarah worked for Ahlberg Supplies and had a covenant not to compete. Darcy acquired Ahlberg and assumed all its assets and contracts. Does Sarah's covenant not to compete still apply with respect to Darcy?
Yes, the assignment of the contract did not alter Sarah's duties under the covenant.
5. George is to be paid by Geraldine under a contract. George assigns the right to receive these payments to Hugh. If Geraldine fails to make the required payments, from whom may Hugh recover, George or Geraldine?
Both, Hugh may recover from Geraldine as assignee on the original contract and from George under the assignment contract, unless it specifically provided otherwise.
6. Wayne agrees to purchase a house from Garth only if Garth obtains a structural inspection report. Garth gets a report from Inspectors, Inc. that declares the house structurally sound, so Wayne goes ahead with the purchase. Serious structural flaws existed in the house. Can Wayne successfully sue Inspectors?
Although Wayne is only a third party to the Garth/Inspectors contract, he is probably an intended beneficiary of the contract, which would permit him to proceed with his case against Inspectors.
7. In the absence of a specific contract provision, can a homeowner assign the mortgage to a buyer?
No, the assumption of a mortgage by a different party affects the lender's ability to recover. Thus, there are special assumable mortgages that may be assigned, though the assignor remains liable on such mortgages.
8. Mario had a contract to rebuild the engine on Lin's car by the end of the week. Mario was overworked and delegated the job to the company across the street, which rebuilt the engine. Mario paid that company for the work. When Lin learned of this she refused to pay. Can Mario recover the contract price from Lin?
Yes, unless there was something unique about Mario's ability to rebuild the engine. In ordinary circumstances, the delegation did not affect the quality of the job and was lawful.
9. Operation Systems (OS) sold software for accounting systems. OS promised Huff Companies that this accounting system would function for their purposes and was error-free, and Huff agreed to purchase a substantial amount of the software. Before the software was delivered, OS sold its accounts receivable to IBM. After the software is delivered, Huff discovers that the software is ill-suited for their purposes and makes serious mathematical errors. Huff consequently refuses to pay OS for the software. IBM demands payment from Huff under the assignment contract and sues to recover. Can IBM recover from Huff?
No, because of the "shoe rule." Although IBM has not committed fraud or anything else wrong, IBM is assuming the contractual rights of OS. OS has committed fraud or breached its contract with Huff. Because IBM must stand in the shoes of OS, these defenses are also effective as against IBM. IBM may defend its rights only by arguing that OS has not committed fraud or breached the contract.
10. Abby's Cakes agreed to lease space in a shopping center from Colonial Palms Plaza, Ltd. The lease contract contained a provision wherein Colonia agreed to provide Abby's an \$11,250 construction allowance once Abby's had completed certain stipulated improvements on the property. The lease contract also had a provision stating that Abby's would not "assign, mortgage, pledge, or encumber" the lease without first obtaining Colonial's

consent. Before the improvements were completed, Abby's assigned its right to receive \$8000 of the construction allowance to Robert Aldana without asking Colonial, and Aldana loaned the sum back to Abby's for the improvements. After the fact, Abby's notified Colonial of the assignment. After Abby's completed the improvements, Colonial failed to pay the construction allowance to Aldana, citing the anti-assignment clause. Aldana sued for the \$8000; should he prevail?

In this case, Aldana v. Colonial Palms Plaza, Ltd., 591 So.2d 953 (1992), the court held for Aldana. The anti-assignment clause was not enforced because it was contrary to public policy. There is no sound reason to preclude or condition the assignment of cash, because this does not alter the obligor's requirements in any fashion. Such assignments also encourage the efficiency of the market.

Further Readings

Basic Readings

West's Business Law, Sixth Edition, Clarkson, Miller, Jentz, and Cross (1994), Chapter 17 — This chapter of the university business law text addresses issues of third-party rights in contract.

Contracts in a Nutshell, Gordon D. Schaber and Claude D. Rohwer (3d ed. 1990), Chapters 10 and 11 — These chapters of the simplified legal guide discuss third-party beneficiaries and assignment and delegation.

Intermediate Readings

Corbin on Contracts, Arthur Linton Corbin (1963), Chapters 41-52 — These chapters of the multivolume treatise discuss third-party rights in contract.

Contracts, John D. Calamari and Joseph M. Perillo (2d ed. 1977), Chapters 17-18 — These chapters of the hornbook address third-party beneficiaries and assignments and delegations.

Advanced Readings

Restatement of the Law (Second) of Contracts, American Law Institute (1979), Chapters 14 and 15 — These chapters of the official review of American contract law address third-party beneficiaries, assignment, and delegation.

Melvin Aron Eisenberg, "Third-Party Beneficiaries," 92 *Columbia Law Review* 1358 (1992) — This article discusses the evolution of third-party-beneficiary law and challenges some of the leading holdings.

Anthony Jon Waters, "The Property in the Premise: A Study of the Third Party Beneficiary Rule," 98 *Harvard Law Review* 1109 (1985) — This article reviews third-party-beneficiary law and its implications for public policy.

Lecture Eight

International Contracts

Scope: International law presents new complications to any legal issue – in contract law, jurisdiction, language and credit issues become paramount in the performance and enforcement of international contracts. A primary issue of course, is under which laws will the contract be drawn up? Some guidance is given by the United Nations' Conventions on the International Sale of Goods, but they contain key contrasts with U.S. law.

Outline

- I. Complications.** Entering international contracts raises a number of complications, both practical and legal.
 - A. Forum.** In an international contract, there may be uncertain issues regarding the law applicable to the contract and the place where a lawsuit may be filed. Significant differences in contract laws, legal systems, and lawyers among nations may produce different outcomes in contract disputes, depending upon the place of litigation and law applied.
 - B. Language.** Language also creates a problem in international transactions. Simple attempts to translate may not work well, as meanings are seldom identical.
- II. Convention on the International Sale of Goods.** To add some uniformity to international goods contracts, the United Nations provided the Convention on the International Sale of Goods (CISG). These rules are potentially an international U.C.C.
 - A. Application.**
 - 1. Nations Covered.** The CISG applies only to contracts of companies from those nations that have ratified it. Ratification is not uniform but does include some commercially significant nations, such as the United States, Mexico, Germany, China, Russia, and France. Even in these contracts, the parties may disclaim the application of the convention if they choose.
 - 2. Commercial Contracts.** The CISG applies only to commercial sales, not consumer sales of goods. It does not apply to stock transactions.
 - B. Contrast with U.S. Law.** The CISG differs from United States contract law in several respects, including the following.
 - 1. Offer and Acceptance.** An offer is irrevocable under the CISG if the offeror so states, even without consideration. Nor is there a mailbox rule that makes acceptances effective upon dispatch.
 - 2. Contract Form.** There is no statute of frauds provision in the CISG, which parallels most nations other than the U.S.
 - 3. Remedies.** Specific performance is more broadly available under the CISG than under U.S. law. Buyers may reject nonconforming goods, but sellers are given some additional time in which to cure the problem.
 - 4. Validity Issues Not Addressed.** The CISG generally does not resolve issues of the validity of the contract, such as fraud, mistake, and unconscionability.
 - C. Letters of Credit for Collection and Payments.** Given the greater uncertainty of international law, parties have developed a letter of credit system to facilitate payment.
 - 1. Functioning of Letter of Credit.** When companies from two different countries enter a contract, they may select a bank as a middleman to cut down costs and add certainty to payment. The bank is usually one with branches in both countries.
 - 2. Compliance with Letter of Credit.** When the seller sends the goods, it then presents documents to the bank middleman. These documents include the contract and documents of shipment (bill of lading, licenses, certificate of inspection). The bank then makes payment based only on these documents. The bank then seeks reimbursement from the buyer. The bank thus assumes the risk of buyer nonpayment. The bank does *not* look to the actual delivery or shipment of the goods but only to the documents. If

the shipment was flawed and the buyer doesn't pay the bank, the bank must then try to recover from the seller the monies that it had previously paid out.

3. **Strict Compliance Rule.** Under traditional rules, strict compliance is required. Because payment is based on documents, the papers must be exactly correct or the bank need not pay.
4. **Standby Letter of Credit.** The traditional letter of credit protects only the seller, but new forms protect the buyer. Thus, the seller may be required to provide a letter of credit that the buyer can draw upon in the event of the seller's breach.

Review Questions

1. Companies from Spain and the United States enter into a commercial contract for the sale of goods, specifying that U.S. law will apply. If there is a dispute, will this be resolved under the CISG or the U.C.C.?

The U.C.C. will apply, because the companies voluntarily declared that U.S. law would govern the contract.

2. A Mexican company and a Chinese company enter into a contract to be performed in the United States. What law may they choose to apply to their contract, and where may the case be heard?

The companies may choose any law, including that of Canada or other country, and may choose to litigate the case in any location of their choice. The choice must be considered "reasonable," however.

3. Federal Bank issues a letter of credit backing a contract between Combustion Company (the seller) and Taurus Associates (the buyer). Must Combustion wait for delivery to Taurus to receive payment?

No, Combustion is entitled to be paid as soon as it provides the required documents to Federal, even before delivery.

4. A sales contract is governed by the CISG. The acceptance is clear in its intention to make a contract but adds additional terms to the offer. Are these terms part of the deal between the parties?

No, in fact the parties probably have no contract, as the CISG requirements are close to those of the common law mirror image rule.

5. A U.S. company makes an oral offer to sell \$100,000 in goods to a German company and states that the offer will be held open for two weeks. After a few days, the American company tries to revoke the offer, but the German company accepts and tries to hold the U.S. corporation to the offer. Do the parties have a contract?

Yes, because the CISG does away with the statute of frauds and does away with the requirement of consideration for offer irrevocability.

6. Under the CISG, when does an acceptance of an offer become effective and create a contract?

Only when received by the offeror.

7. Intel had a contract to ship three hundred and eighty-six chips to a Japanese company under a letter of credit. Intel shipped the three hundred and eighty-six chips as specified in the contract, though the shipment documents stated that four hundred and eighty-six chips were sent, due to a typographical error. The bank refuses to pay Intel. Is this correct?

Yes, the bank need only pay when the documents are correct, and they were not. This is true even though four hundred and eighty-six chips are superior to three hundred and eighty-six chips.

8. Intel has a contract to ship chips to a Japanese company under a letter of credit. Delivery occurred before the documents were presented, and the Japanese company found the chips seriously defective. Can the Japanese company arrange to halt payments on the letter of credit?

No, if the documents presented to the bank were in order. The Japanese company can avoid paying the bank, however, if the chips were indeed defective.

9. Chilewich International, a New York corporation, contracted with a Russian company, Raznoexport, for supply of boots. The contract stated that disputes would be arbitrated in Moscow. Chilewich then sent an Italian footwear manufacturer, Filanto, S.P.A., "the standard contract in effect" with the Russian buyers. Chilewich had previously used Filanto as a manufacturer. Chilewich then sent Filanto a memorandum confirming that Filanto would deliver 100,000 pairs of boots at the Yugoslav border on September 15 and an additional 50,000 pairs on December 1. The memorandum referred to the arbitration clause in the Russian contract. Filanto returned the memorandum several months later but objected to the arbitration clause. Both companies proceeded with performance, but Chilewich eventually complained that some of the boots were defective and refused to pay. Filanto contended that the boots met all the requirements of the Russian contract and filed a lawsuit in the United States for payment, but Chilewich contended that the dispute had to be arbitrated in Moscow. Must the dispute be referred to arbitration?

In this case, Filanto, S.P.A. v. Chilewich International Corp., 789 F. Supp. 1229 (S.D.N.Y. 1992), the court held that the dispute must be submitted to arbitration. The CISG applied to the transaction, and under the Convention Filanto should have promptly objected to the incorporation by reference of the Russian contract. Given the prior dealings between the parties, Filanto's objection came too late. When Filanto claimed the boots were not defective, it pointed to the Russian contract for proof. This was an implicit acceptance of that contract, including the arbitration clause.

10. All America Export placed an order for thousands of pounds of yarn from A.M. Knitwear, using an All America Export purchase order form. The form specified the terms of the contract, stating "pick up from your plant for shipment to Brazil." The contract also said the sale was FOB but the place for delivery was left blank. All America Export sent a shipping container with a freight forwarding company, and A.M. loaded the yarn into the container. Before being picked up by the transporter, the yarn was stolen. All America Export refused to pay, and A.M. sued. Who should win this case?

In this case, A.M. Knitwear Corp. v. All America Export-Import Corp., 41 N.Y.2d 14 (1976), the court held for All America Export. The term FOB places the risk on the seller until actual delivery to the carrier, and placement in the container did not satisfy this requirement. The blank space on the document made no difference, as the seller was required to have negotiated specific language modifying the FOB term.

Further Readings

Basic Readings

West's Business Law, Sixth Edition, Clarkson, Miller, Jentz, and Cross (1994), Chapters 10 and 56 — These chapters of the university business law text addresses issues of comparative national laws and the international legal environment.

International Business Transactions in a Nutshell, Donald T. Wilson (2d ed., 1984), Chapter 16 — This summary of law address strategies for negotiating the terms of international contracts.

Intermediate Readings

International Business Law and Its Environment, Schaffer, Earle, and Agusti, (2d ed., 1993), Chapters 4, 5, and 7 — These chapters of the textbook address international sales contracts, collections, documents, and letters of credit.

Law for Global Business, Eric Richards (1994), Chapters 5 and 6 — These chapters of the textbook address international contracts and contracts for the carriage of goods between nations.

International Law for Business, Carolyn Hotchkiss (1994), Chapters 6, 7, and 8 — These chapters of the textbook cover international contract law and letters of credit.

Advanced Readings

Transnational Contracts: Law and Practice, Georges Delaume (1983) — This book addresses legal principles central to the drafting of international contracts.

Joseph M. Perillo, "Unidroit Principles of International Commercial Contracts: The Black Letter Text and a Review," 63 *Fordham Law Review* 281 (1994) — This article reviews the law of international contracts, including both the CISG and other rules.

James W. Weller, "International Parties, Breach of Contract, and the Recovery of Future Profits," 15 *Hofstra Law Review* 323 (1987) — This article considers the problems associated with enforcing international contracts and recovering damages.